

University of Dundee

Dundee Discussion Papers in Economics 227

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Publication date:
2009

[Link to publication in Discovery Research Portal](#)

Citation for published version (APA):

Morelli, C. (2009). *Dundee Discussion Papers in Economics 227: Modern British retailing in the late 20th century: increasing value?* (Dundee Discussion Papers in Economics; No. 227). University of Dundee.

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Dundee Discussion Papers in Economics

Modern British Retailing in the Late 20th Century: Increasing Value?

Carlo Morelli

Modern British Retailing in the Late 20th Century: *Increasing Value?*

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The rise of large-scale retailing represents arguably one of the success stories of British business in the second half of the twentieth century. Growing consumer prosperity after the Second World War saw rising demand for an ever widening array of consumer products, leading Prime Minister Harold MacMillan to famously suggest that the public had 'never had it so good'. To match these changes innovations from the United States were adopted by leading British retailers from the 1950s, especially in the fields of store size and layout, product packaging and marketing. A new wave of innovation emerged, this time generated from within, during the 'Golden Age' of retailing from the mid- 1970s to the mid-1990s, when further advances in new store development, supply chain management and the use of information technology became widespread. Thus over the period of half a century British retailing had become a leading sector for innovation within British business. As a result by the 1990s British retailing had not only become oligopolistic, and the subject of repeated anti-monopoly investigation, but the largest retailers were now turning to internationalisation as they themselves began to transfer their own technological know-how into new markets.

Historians and other scholars had little to say with regard to modern retailing prior to the 1990s. The focus of much of the literature was upon the predominance of small scale, family-owned and independent shopkeepers in the nineteenth century which were increasingly undermined by multiple retailing organisations, variety and department stores along with co-operative retailing [Davis, 1966; Jeffreys 1954; Mathias 1967; Winstanley 1983]. More recently, however, business historians and geographers interest in retailing has grown substantially. Issues of organisational capabilities and the nature of competition have been the focus of much attention, with particular reference to the growth of retailer's own-brands (Williams, 1995), logistics and distribution (Sparks, 1995), market structure (Moir & Dawson, 1990; Winstanley, 1994) and the post-war challenge to manufacturer imposed resale price maintenance (Morelli, 1997). By the twenty first century retailing had become a main stream area of academic research with internationalisation (Wrigley, 2000; Godley and Fletcher, 2000), competition and policy (Blythman, 2004; Coe 2004; Hallsworth and Evers, 2004, Hines, 2000; Hughes, 2005; Morelli, 2004 & 2007), trade (Dolan and Humphrey,

2004) and innovation (*Alexander, Shaw and Curth, 2005*) to name but a few areas of contemporary interest.

This chapter does not seek to review all of this growing body of work, rather it sets itself a more modest, yet arguably more important, task. As recently as 1995 Akehurst could hope that 'a general theory of competition in retailing may be developed' (p.43). Unlike competition between firms within manufacturing industry retail competition has never simply resulted in competition between retailers over price or quality for substitutable goods. Retail competition has at each stage in its development centered upon competition between differing forms of retail format and business's organisational form rather than over substitutable goods. Thus the approach of adopting concepts of competition from manufacturing and simply applying them to retailing has proven problematic. It is therefore to the question of providing a theoretical understanding of the economic role of retailing and competition that this chapter addresses. The chapter explains innovation, in the form of organisational structures and retail format, as central to understanding competition in the retailing environment, especially in the second half of the twentieth century. It suggests that innovation, in particular the way in which it impacts on the supply chain, is central to understanding competition within retailing and that the importance of innovation lies with the market power innovation provides retailers over the supply chain in relation to manufacturers.

The chapter therefore seeks to develop a framework, available to business historians, for an understanding of the business function of retailing and provide an explanation for the dynamic nature of the sector in contrast to much of manufacturing in the period. The unique importance of retailing's economic function, in realising value rather than simply creating value, is suggested to lie at the economic heart of the retailing function. This has allowed retailers to successfully change the balance between markets and hierarchies at different times in their development. It is these changes that have given rise to new retailing formats. In so doing retailers provide an example of organisations where the boundaries between markets and hierarchies are increasingly blurred and are themselves perhaps more accurately understood within a transaction cost framework of a nexus of contracts. Using new institutional economics and an understanding of market power, contracting is shown to adapt to changes in the importance of manufacturer branded goods, retailer own-label goods and asset specific investment in retailing outlets, computer technology and logistics. Finally, the chapter examines these changes in more detail through the history of Britain's largest food retailer, Tesco PLC. Food retailers, most notably Tesco, led the changes in retailing that this chapter identifies are key to understanding the dynamic relationships that retailers have managed to create in the late twentieth century.

The Rise of Retailing

Retailing in Britain has undergone numerous 'revolutions' as new forms of retailing challenged existing methods for marketing goods to consumers. Competition within retailing became characterised not simply by competition over price and location between similar organisations, referred to as intra-type competition, but also by competition between very different retailing formats, referred to as inter-type competition (*Shaw G, Alexander A, Benson J, and Hodson D, 2000*). So, itinerant merchants faced competition between themselves and between their form of retailing and that of fixed store retailing for the provision of goods to consumers by the nineteenth century, full-service provision was challenged by self-service retailing after the Second World War, small stores by large supermarket retailing by the 1960s and town-centre by out-of-town hypermarket retailing by the 1980s and still more recently e-retailing in the 1990s. Thus competition in the context of the history of retailing is typically a history of competition between forms of organisation as between firms themselves.

Internally, firms were emerging by the mid-nineteenth century in the United Kingdom that moved beyond the single store structure with multiple store organisations establishing themselves by the eighties with WH Smith and John Menzies in the book trade, followed shortly afterwards in food with firms such as the Maypole Dairy Co., Lipton Ltd and the Home and Colonial Tea Company, in footwear with Freeman Hardy & Willis, tobacco with Finlay & Co., oil and paint retailing with George Mence Smith, and pharmacy with Boots Pure Drug Co. to name but a few (*Jeffrey's, 1954, pp.23-25*). Large city centre department stores and mail order firms were similarly all in existence before 1900 with Schoolbred being dated back as far as 1820 (*Shaw, 1992*). Most significantly of all, the Co-operative Wholesale Society (CWS), originating in 1844 but by 1900 already responsible for between six and seven percent of retail sales, had established international and purchasing, warehousing facilities in Ireland, the US, the East Indies, France, Denmark, Germany, Canada and Australia. (*Birchall, 1994; Jeffreys, 1954, table 7*). The CWS had also diversified beyond retailing of foodstuffs and into food manufacturing, clothing, footwear, soap and furniture. By the First World War the CWS was by far and away the largest retailer in the world.

In the area of consumer marketing retailers were also developing new forms of competition before the twentieth century. The development of the co-operatives spread fixed price retailing and 'honest dealing', leading to quality and service becoming the hallmark of consumer marketing for the rising numbers of multiple firms. Similarly, the development of the Co-op's 'dividend', an early form of loyalty card and saving scheme, emerged as retailers sought to establish loyalty between consumers and retailers was in many respects a precursor to the relationship marketing that retailers would focus upon in the 1990s.

The interwar years saw, as in other industries, a merger movement occur which introduced both new scale economies and new forms of specialisation. The number of firms with 25 or more branches grew continuously from 58 in 1920 to 89 by 1939 with the number of stores operated by these multiples rising from 6,719 to 12,062 (*Jeffreys, 1954, p.137*). Whereas multiple retailing had emerged in a number of important areas of retailing before 1900 it had by the interwar period become common place across all sectors. The largest multiples now achieved national coverage while many regional multiples also emerged. Jeffreys seminal study details the growth of multiple retailing across a wide range of trades including; grocery and provision, meat, bread and flour confectionary, milk, fruit and vegetables, fish, chocolate and sugar confectionary, tobacco, newspaper, stationary and books, clothing, footwear, chemists and druggists, sewing machines, bicycles, electrical goods, jewellery, toy and sports goods, furniture and household goods trades.

These large-scale retailers, focusing upon a narrow range of goods, developed further specialisation by buying in bulk and integrating their warehousing and distribution within the firm (*Fulop, 1964*). The inter-war era also brought co-operation between retailers and manufacturers aimed at restricting price competition with the spread of resale price maintenance on branded goods (*Yamey, 1966*). Price maintenance, although successfully introduced, did not go unchallenged during the 1930s as discounting retailers emerged in food retailing with Tesco and in clothing Marks & Spencer avoiding branded goods by producing own-label clothing (*Fulop, 1964, p.72*).

The Second World War reduced competition still further and by the time rationing ended in 1954, retailing was ready to see rapid changes in the retailing industry. By the 1950s discounting retailers', particularly in food retailing, had broken manufacturer-imposed resale price controls and begun to introduce new forms of retailing with self-service and supermarket retailing formats. While the co-operative movement led in the introduction of self-service stores it was with the private multiple food retailers, such as Sainsbury and Victor Value, where supermarket retailing emerged most strongly (*Morelli 1998*)

Rising spending power and the rise of consumer society saw significant changes in patterns of consumption. While food expenditure fell as a proportion of total expenditure from 29.1% of consumer expenditure to 17.2% between 1950 and 1980 the volume of food consumption could still rise 40% over the same period. Over the same period expenditure on motor vehicles and fuel could rise from 1.9% of consumer expenditure to 10.4% (*Pollard, 1983, table 7.32*). The spread of consumer durables including refrigerators, washing machines and other domestic electrical devices along with the mass ownership of cars all contributed to this rapid growth of consumer society.

This growing consumer society together with retailers' locational advantages through ownership of limited high street sites helped contribute to the dominance of larger retailers in high streets across Britain. Retailing firms themselves, it should be stressed, were not however uniform in their responses to the opportunities a new consumer society brought. While some larger retailers, such as Tesco, made use of public liability ownership structures to gain access to capital market finance, others, such as Sainsbury, preferred continued family control and incremental growth. The growing importance of retailing in the supply chain continued until the next 'retail revolution', with hypermarket retailing, the emergence of out-of-town shopping and one-stop shopping in the 1980s. During this 'Golden-Age' de-regulation of land use and planning controls permitted the rapid expansion of new out-of-town development (Wrigley, 1991). The largest retailers now increased the scale and scope of their operations, with food retailers moving into clothing, household durables, electrical goods and even financial services while in clothing retailers such as Laura Ashley's and Next moved into household furnishings and decorations and financial services. In the 1990s retailers began to look at internationalisation as domestic saturation and limited new sites threatened to stall further expansion and increased government concerns over large multiples impact on competition led to repeated anti-monopoly investigations by the Monopolies and Mergers Commission in 1981, the Office of Fair Trading in 1985 and the Competition Commission in 2000 (Langston, Clarke & Clarke, 1998)

By the turn of the century British retailers were turning to internationalisation as a major route to future growth. By 2003 the leading British retailer, Tesco, had moved into 12 markets in West Europe, Eastern Europe and East Asia. In internationalising however, British retailers were attempting to catch up with much larger US and European firms, most notably the US retailer Wal-mart with stores in eleven countries, the Dutch retailer Ahold with stores in 27 countries and the French retailer Carrefour with stores in 32 countries. By 2003 Tesco was the only UK retailer listed in the top 15 international retailers by sales (Coe and Lee, 2006).

While this picture of the growth of big business has dominated academic work the continued prevalence of small-scale retailing organisations has continued, despite attempts to write its obituary (Raven and Lang, 1995). The existence of low barriers to entry has made this sector a sector open to new entrepreneurial immigrant populations and those excluded from wider labour markets, whether bringing new forms of restaurant in the form of Indian cuisine to indigenous consumers or satisfying demand for newer immigrant populations. Thus during the twentieth century retailing became a more complex industry with a range of distinct sectors. Within each sector a process of polarisation within the industry between larger multiple retailers and smaller local niche markets emerged limiting competition.

In the development of large-scale retailing, however, evolutionary quantitative change gave way to fundamental qualitative changes with the development of new forms of inter-type competition. Retailers were able to develop new forms of market power and challenge manufacturers' price setting abilities. This shift was further aided with government's intervention from the banning of resale price maintenance from 1956 to the increasing role in regulation given to retailers by government in the 1990s (*Marsden and Wrigley, 1995*). The emergence of multiple retailers' market power derived from increased levels of asset specificity; as scale increased and new technology was adopted, so new economies of scope emerged. As the following section aims to show, explaining these changes requires recognition of the uniqueness of the retailing function.

Retailing Theory & Business History

As highlighted above, because competition within retailing encompasses more than simply price, quality or location and includes form it has been recognised that retailing requires alternative theoretical developments to be developed within business history (*Akehurst and Alexander, 1996; Benson, 1994*). Yet retailing creates some difficulties for business historians in attempting to develop theories for its development and growth. Business history has typically represented retailing within an eclectic theoretical framework, one in which elements from disparate and even conflicting theories are moulded to specific needs. Yet there remains a deep, yet rarely acknowledged, polarisation between approaches which use either transaction cost or value chain analysis. In what follows I seek to highlight this divergence and outline a resolution that enables a consistent theory of retailing to emerge based upon retailing's role in value realisation (*Doel, 1996*).

Chandlerian (1990) business history rooted within a transaction cost approach, derived from Coase (1937) and Schumpeter (1965), developed through *Williamson (1986) and Casson (1995)*, and extending into an evolutionary tradition of *Langlois & Robertson (1995)* rests on the neo-classical recognition of profit maximisation and productive and allocative type efficiencies. While these theories are far from uniform and conflict over important issues, not least the role of entrepreneurship and the explanation for the development of hierarchical organisation, they nevertheless share a series of common concerns relating to production cost structures and most importantly the use of information.

It is information, in the form of tacit or implicit knowledge, which provides the rationale for internalisation and a theory of the firm within a Coasian framework. The heroic ability of Schumpeterian entrepreneurs, derived from this unique knowledge, finds expression through the innovative development of production orientated organisations. Alternatively, the less visible, but more extensive, market making opportunities of Casson-type entrepreneurs create investment

opportunities within culturally-based contexts of high or low trust market economies. Finally, Langlois and Robertson maintain that dynamic information costs provide a rationale for internalisation. As *Langlois and Robertson (1995, p.37)* make clear;

‘Ultimately, the costs that lead to vertical integration are the (dynamic) transaction costs of persuading, negotiating with, coordinating among, and teaching outside suppliers in the face of economic change or innovation.’

While dynamic transaction costs provide encouragement to hierarchy over markets it is not the case that the transaction cost analysis deterministically maintains the superiority of hierarchy over markets for co-ordination. Indeed the classical school from Smith to Stigler would maintain that in the long-run markets predominate as tacit information, in the form of capabilities, becomes transformed into codified information in the form of routines, and thus become transferable between organisations. Within retailing innovation is particularly liable to transfer due to the limited role of patenting or copyright within the industry, such that only branding provides some control over property rights of innovation. Thus while innovatory firms make cost savings through internalisation, in the long-run, market based learning encroaches into the idiosyncratic firm specific capabilities.

The conclusion deriving from this literature, when applied to an industry such as retailing, is that it is production efficiency, technological change and innovation which lead to relative price change. Thus we have a theory of dynamic change but not one which provides predictions on the degree to which vertical integration or disintegration may take place.

Within the management literature a wider concept of value is used to evaluate firm development. Value, combining elements of price, consumer’s desire and satisfaction is used to move away from economist’s narrow preoccupation with product homogeneity in markets. Value clearly has some similarities to economist’s knowledge of utility in that it is through consumption that value is understood. Individual consumers value branded and unbranded goods differentially and base their decisions on purchasing on this knowledge. However, in contrast to utility value is considered to be constant for each good irrespective of how many are consumed by an individual whereas consumers from an economic perspective are considered to face declining marginal utility rates. Therefore value is closer to price in that it is the commodity itself which embodies the property of value rather than the consumer and, as with property rights, value may then be transferred through exchange (*Adcock, et.al.,1998, p.218*).

Commodities are said to gain value through the operations of the firm from production to marketing and sales. An understanding of value-adding is then used to examine the degree to which firms are successful in adding value in the

production process. Porter's value-chain approach thus provides a core component of management literature on firm behaviour (*Porter, 1985*).

Through the choice between markets and hierarchies firms are able to capture a greater or lesser degree of the value added. A clear similarity exists here in the conceptual understanding of transaction cost economics and value-chain analysis. The greater degree of ownership of value-adding activities within the firm ensures a greater degree of idiosyncratic capabilities emerge, allowing value to be created and retained within the hierarchy.

However, while a significant overlap exists within the two approaches there remains a fundamental problem in combining the two, namely value and price are demonstrably different. For example, changes in technology leading to relative price changes in computing has led to rapid declines in relative prices while simultaneously further value has been added to these commodities. Price and value are distinct and typically have a negative relationship.

In the case of retailing *Johnson and Schols (1999, p.6)* maintain that firms such as the furniture retailer IKEA are able to utilise changes in the supply chain to create competitive advantage. Through the adoption of modern styling, durable design and immediate availability IKEA have been able to revolutionise the home and office furnishing markets. One of the key changes within IKEA's development was the shift of responsibility to consumers for specific manufacturing and retailing tasks. Consumers purchased flat-pack furniture from the store transported it and assembled it themselves. While we can recognise this as a cost minimisation approach adopted by IKEA within a value chain context it is suggested that removing these tasks from the firm's value chain permits still further value to be added. Thus Johnson and Schols maintain that,

'IKEA... encourage(ed) customers to create value for themselves by taking on certain tasks traditionally done by the manufacturer and retailer, for example the assembly and delivery of products to their homes.'

The fundamental problem with this approach is the suggestion that consumption adds value. If value is not synonymous with price and measured in a monetary form it is just a short step to suggest that value can be continually added even after commodities are consumed. In so doing the concept of value and the suggestion that all activity, even consumption, adds value removes all analytical content to the term 'value'.

Nowhere is this conceptual problem more acute than in a study of retailer supply chains. Elsewhere I have argued that the division between manufacturer, wholesaler and retailer has been neither static nor mono-directional over time (*Morelli, 1999*). Currently, particularly within food retailing, the movement is towards sub-contracting and disintegration. However, this is not on the basis of classical or simple bi-lateral contracting (*Foord, Bowlby and Tillsley, 1996, table*

4.1). As Foord et.al. make clear relationships are much more extensive, relational and reflect a wider balance of power between retailer and manufacturer. The crucial question posed by this movement towards disintegration is; what has happened to the understanding of value-adding-in this process?

While it is theoretically consistent to suggest that retailers are minimising transaction costs through discrete bi-lateral trading it cannot be readily maintained that retailers have added value through disintegration. Disintegration has either passed value-adding functions to suppliers or removed functions that add no value (or in extreme even destroyed value) from their own organisation. In the case of value-adding functions being passed further down the supply chain we can readily invoke transaction cost analysis to suggest that specialisation and idiosyncratic capabilities are developed by specialist manufacturing, warehousing and logistics firms which retailers are able to recognise but not duplicate. Certainly, Casson (1990, p.53) would suggest that all economic activity leading to problem solving is productive activity;

'In practice... problem identification and problem investigation are also productive - they add value and are, indeed, indispensable to the wealth-creation process.'

Indeed there is some prima facia evidence here for the movement towards disintegration and the linkages between food retailers and specialist warehousing firms. British food retailers lead the world in stock turnover and minimising the time from manufacturing to customers' kitchens (*Fernie, 1995*). However, again, this value-adding takes place against a background of falling relative prices bringing into question the mechanisms for realising this value.

The management focused literature on retailing, recognises the role and importance of vertical integration, development of multi-national corporations and marketing, in certain respects sits very easily within the business history framework. However its adoption of the value-chain as a mechanism for understanding the development of competitive advantage gives rise to a departure from a more economic approach of transaction cost analysis.

In cases where value neutral or even value destroying functions have been passed down the supply chain a theoretical understanding of vertical disintegration is not so straight forward. We can readily recognise within transaction cost approaches retailers removing themselves from elements of the warehousing and distribution systems which they are unable to develop the capabilities to add value and suggest retailers have therefore retreated into their core competence of realising the value of the commodities sold. This, however, poses the theoretical problem of how do the specialist disintegrated firms exist if they themselves do not create value? Under such circumstances transaction cost and value chain analysis diverges in its understanding of retailing.

By re-introducing a distinction between value creating and value realisation functions it is however possible to rethink the role of the supply chain. The actions associated with processing and manufacturing products need to be distinguished from the costs incurred in ensuring goods reach markets and their value realised through their sale to consumers. The retailing function should be understood not as creating value in commodities but in ensuring the value generated in the production processes can be released, through consumption. Retailing is an intermediary market function required for value to be realised.

Retailing's growth, decisions on the use of hierarchies or markets then becomes one in which the transaction cost minimisation strategies developed by retailers seek to maximise retailers' share of revenue derived from the sale of commodities whose value has been generated in previous areas of the production process. Retailers are thus intermediary forms of organisation creating market environments between manufacturers and consumers. Within this view inter-type competition emerges precisely because retailers seek to develop innovative methods of sales and marketing to consumers in order to maximise their share of the value previously generated. Developments in scale and scope, format and location, and IKEA's removal of assembly functions are all examples whereby retailers attempt to maximise their share of the value embodied in the product at the expense of manufacturers as well as other retailers.

Much of the contemporary geography approach to retailing is rooted in such a framework (Wrigley and Lowe, 1996; Hallsworth, 1997). Derived from Marx (1970) and classical economists who recognised the labour theory of value, contemporary writers including Thompson (1991), Braverman (1974) and Marglin (1974) have all focused on the importance of control, power and the division of labour as determinants in the development of the firm and organisational structure. In this approach profit maximisation derives from a firm's ability to maximise labour output while simultaneously minimising labour costs. Retailers act as increasingly powerful intermediary institutions in a process whereby labour's output can be sold to consumers. Retailers' market power thus derives from arbitrage opportunities between manufacturers and consumers.

Issues of power within relationships between labour and capital, as well as between organisations are of central importance to much of the recent retailing literature within the field of human geography (Wrigley and Lowe, 1996). From this viewpoint markets and hierarchies are understood as interchangeable structures for the maximisation of economic power by the dominant organisations. Such an approach fits closely with the more sophisticated transaction cost approach favoured by Pitelis (1993) which recognises the firm not as black box structure delineated by ownership criteria but as a fluid co-ordinating organisation delineated by a nexus of contracts.

The Case of Tesco

As the rest of this chapter now demonstrates an examination of the changing approach taken by Tesco in the late twentieth century appears to fit within such an approach. Tesco, established by Jack Cohen in London, was a store which from the beginning in 1931 specialised in the sale of dry packaged branded goods. Although being a publicly limited company the Cohen family, particularly the founder Jack Cohen, dominated the running of the company as a highly centralised family firm. Family connections also played an important part in the management of stores, with Jack Cohen using family members as managers for Tesco stores.

Initially established through price cutting, Tesco rapidly adopted agreements over prices with manufacturers in order to maintain supplies in the 1930s (Powell, 1991, pp. 33-41). However, with the challenge to manufacturer imposed Resale Price Maintenance and its banning by government in 1956 Tesco began to re-establish its reputation for 'pile it high: sell it cheap' food retailing. After 1964, following the announcement of the Resale Prices Act to reinforce the earlier 1956 Act and outlaw individual resale price agreements, Tesco further challenged price maintenance in non-food goods (Corina, 1972, pp.30-31; Pickering, 1966). Like most other grocery retailers Tesco specialised in retailing, rather than wholesaling and manufacturing and as a result did not develop extensive own-brand capabilities. A concentration upon own-brand groceries began to develop from the 1960s onwards but even as late as 1980 Tesco own-brand share as a proportion of turnover was only, at 22%, in line with the industry average (Tesco, 1990, p.5; Euromonitor, 1986, table 5.3, p.28).

Tesco adoption of public limited status by 1949 to gain access to capital markets ensured that Tesco led the adoption of self-service and supermarket retailing from the late 1950s (Corina, 1972, p.127; Morelli, 1998). Tesco was also thus able to gain the necessary capital for growth through take-overs such as Irwins and later Victor Value so that by 1990 Tesco had developed a large branch network extending to 371 stores (Corina, 1972; Simms, 2007, p.88; Tesco Archive, 1990, Williams, 1994, p.219). Despite this growth Tesco were still largely a regional concentrated multiple retailer. It was not until the mid 1990s that a majority of its stores were to be found outside the South East and South West of England (IGD, 1996b, pp.61-2).

Thus until the mid-1970s Tesco looked similar to other large multiple retailers. It was the changes brought about from the late 1970s onwards that saw Tesco emerge as the most significant food retailer in the UK by the mid-1990s. In 1977 Tesco launched the first of a series of innovations within food retailing with its 'Check Out' campaign of deep price discounting in order to develop first mover

advantages and catch-up with the market leader Sainsbury. Heavy investment in increasingly large scale, high street based, supermarket retailing also occurred such that the average selling space in Tesco stores increased to 9,900 sq.ft by 1980 in contrast to the 2,000 sq.ft that supermarkets had been on their introduction into the UK in the 1960s (*Gardner & Sheppard, 1989, p.177*). This was followed by the building of superstores, of over 25,000 sq.ft., in locations on the edge of towns and further centralisation of Tesco warehousing such that 95% of goods, by value, were passing through centralised, retailer controlled distribution warehouses (*IGD, 1996a, p.14*). However, multiple retailers, who previously had undertaken warehousing and distribution operations, now found that the complexity of the retailing environment had increased to such an extent, with product lines increasing to over 31,000 items in the case of Tesco, that they turned to partnerships with specialised independent logistics companies for the management of these processes. By 1992 an average of 51% of stocks, by volume, were supplied to the four leading retailers, Sainsbury, Tesco, Dee (Gateway) and Argyll (Safeway) direct from third party's warehousing operations (*Carter, 1986; IGD, 1996a, p.6; McKinnon, 1996*). Together these changes ensured that Tesco was able to achieve stock turnover rates of 24 times per annum, the highest in the industry and raise their pre-tax margins between 1985 and 1990 from 3.7% to 5.9%, exceeding that of Sainsbury the market leader (*Institute of Retail Studies (1992), table 54 and IGD (1991), table 4.3; Kay, 1993, table 2.1*).

Innovative investment strategies, aimed at creating competitive advantage, were based upon turning high fixed cost into low unit costs while also raising adaptive firms' costs of adaptation, as a barrier to entry (*Lazonick, 1991, pp.95-101*). However, in a rapidly moving and innovative sector, such as retailing, the danger for the innovative firm is that fixed costs for adaptive firms will fall rather than rise as idiosyncratic knowledge becomes tacit and transferable and first mover firms' capabilities become contestable. Thus the discussion of the competitive environment at Tesco's 1995 Chairman's Conference began with the recognition that,

‘we have learnt from experience that we cannot afford to be complacent, superficially, all superstores are looking more similar, and unique differentiation is a prize that can only be won by continually being first’ (*Tesco Archive, 1995, p.1* original emphasis).

Innovation continued into the 1990s with a greater focus upon the consumer. Tesco introduction of ‘Clubcard’ loyalty cards in 1995, despite the cost of half of one percent of sales stemmed, from a recognition of the importance of the ‘primary’ shopper (*IGD, 1996b, p.6*). The primary shopper, spending over 50% of their grocery budget in one store was now increasingly important for the success of the larger, less accessible, out-of-town superstores (*Tesco Archive, 1988, section 3.3*). From 1985 Tesco recognised the need to focus upon primary shoppers and ‘who they are’ (*Tesco Archive, 1985; Tesco Archive, 1989, p.3*). They were already aware that primary shoppers represented 2.5 million (33%) of Tesco

weekly shoppers and that they were responsible for 80% of sales. Below this key group were the 1.6 million (22%) secondary shoppers who were spending over 10% of their weekly food budget within the store but only accounted for 16% of turnover and the 3.4 million (45%) of tertiary shoppers accounting for 4% of turnover. Tesco, were able to use loyalty cards to collect unique computerised information on customers purchasing patterns. In return customers collect points, based upon spending within stores, which can then be redeemed against future spending or a range of other goods and services. One recent estimate suggests there are some 25 million Clubcards in existence of which some 10 million are active (*Simms, 2007, p.96*). Tesco produces separate magazines for its Clubcard members, based upon the categories students, young adults, families, older adults and pensioners (*Retail Week, 1996, p.3*). As Tesco's Director of Corporate Marketing acknowledged early on the company had 'only scratched the surface' with the accumulated data (*IGD, 1996b, p.94*). Nevertheless they recognised the 'key importance [of the primary shopper] to the business' and the need to 'increase the percentage of primary shoppers' (*Tesco Archive, 1989, conclusion*). Finally, from the mid 1990s Tesco took a strategic decision to internationalise its retailing operations and, as described above, rapidly became one of the top fifteen transnational retailers (*Coe and Lee, 2006*).

Conclusion

The importance of these innovations for our understanding of retailing is the recognition that Tesco innovative strategy was based on the need to increase the firms' market power. Innovations, in the form of increased scale, developing information databases on customers from the Electronic Point of Sale (EPoS) technology provided the company with inter-type forms of competitive advantage over rival retailers but more importantly increasing influence over suppliers. Vertical integration, and disintegration, within the supply chain altered as firm's gained increased influence and control over the supply chain. In doing so margins could be increased, not through adding-value but through the forcing of lower unit cost operations on firms higher up the supply chain. Tesco, and other retailers, could vertically disintegrate their supply chains and instead resort to contracting with external warehousing and logistics companies for warehousing and distribution functions, without any loss of control. Simultaneously innovation in inter-type hypermarket retailing formats reduced consumer's ability to substitute goods in a more monopolistic retailing environment. Thus Tesco could integrate forward towards consumers using direct marketing via their Clubcard information systems to increase their proportion of primary shoppers and hence raise margins.

Finally, it is necessary to recognise that none of these changes can be automatically assumed to have increased 'value'. Indeed, increased monopoly powers, the growth of consumer protest against continued expansion suggests perhaps the opposite and that Tesco's operations may indeed be detrimental to

consumer welfare, that is value destroying, if their market power is sufficient to prevent competitive rivalry from emerging.

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